

BATTLE OF THE BONDS

Story of Rothschild's victory at Waterloo not so decisive.



BY JOHN ILKIW

Over drinks and dinners in the world's financial communities there is often the recounting of how the Rothschild family made its

fortune by speculating on the outcome of the Battle of Waterloo. While the details of each recounting vary, they all rest on the understanding that Nathan Rothschild had advanced knowledge of Napoleon's defeat at Waterloo. Rothschild then bought heavily discounted British consols on the London Exchange and within days made a fortune when their price rebounded with news of Napoleon's defeat. Consols paid a fixed coupon rate in perpetuity and were the primary trading instrument on the Exchange.

Richard Bookstaber, in his excellent book, *A Demon of our Own Design: Markets, Hedge Funds, and the Perils of Financial Innovation*, uses Nathan Rothschild's trading strategy to illustrate that portfolio transparency can be gamed to make and lose fortunes. Bookstaber portrays Rothschild standing in his usual spot in front of one of the Exchange pillars and begins to sell consols. Seeing the well-connected Rothschild selling consols and concluding that he knows the outcome at Waterloo, other market participants dump their consols, driving prices to punishing levels. With the market in free fall, Rothschild remains expressionless, while quietly, through a number of agents, buying consols at the bottom, knowing full well their price will skyrocket once Wellington's victory reaches London the next day. The Rothschilds add dramatically to their fortune while those who coattailed Rothschild's activities faced ruin. Bookstaber does not indicate by how much the Rothschild fortune was augmented, but other versions of the events reference amounts ranging from 20 million to 135 million pounds.

This is a great story and a story that I have recounted numerous times over my career to illustrate various principles of investment management: the value of superior

information, the two-edged sword of transparency, how to profit from knowing who holds the weak hand and the sang-froid that is needed to make and profit from a big bet. However, the story is a myth, not reality.

Wanting a fuller understanding of Bookstaber's unreferenced accounting of events, I looked for publications that would give me more details and found two recently published authoritative sources: Niall Ferguson's (1998) *The House of Rothschild: Money's Prophets 1798-1848* and Herbert Kaplan's (2006) *Nathan Mayer Rothschild and the Creation of a Dynasty: The Critical Years 1806-1816*.

Both authors convincingly conclude that Nathan Rothschild did not enrich himself from Wellington's victory at Waterloo. Ferguson argues that the Rothschild fortune was actually at risk because the family was holding large amounts of bullion that depreciated in value due to Wellington's victory, as did the value of their financial contracts with the British government that had been structured under the assumption of a long period of warfare with Napoleon. Having unique access to the Rothschild archives and the papers of the British government about the 1815 events, Kaplan found no evidence indicating that Nathan Rothschild had advance information of the battle's outcome. Further, the first reference of Nathan purchasing government securities comes in correspondence to his brother Carl dated June 30—nine days after Wellington's victory was old news in the London market. Kaplan concludes unequivocally: "There is no evidence that the Rothschilds had made a killing in government securities."

Is the significance of the lessons conveyed by their apocryphal rendition diminished? I think not. Parables and homilies based on the convenient reorganization and fabrication of facts have long been an accepted and powerful tool for communicating valuable life management principles, or in this case, valuable investment management principles. ■

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